230680

BAKER & MILLER PLLC

ATTORNEYS and COUNSELLORS

2401 PENNSYLVANIA AVENUE, NW
SUITE 300
WASHINGTON, DC 20037

TELEPHONE. (202) 663-7820
FACSIMILE. (202) 663-7849

William A. Mullins
E-Mail wmullins@bakerandmiller.com

Direct Dial. (202) 663-7823

July 25, 2011

VIA E-FILING

Cynthia T. Brown
Chief of the Section of Administration
Office of Proceedings
Surface Transportation Board
395 E Street, SW
Washington DC 20423-0001

ENTERED
Office of Proceedings
JUL 25 2011
Part of
Public Record

Re: STB Ex Parte No. 705
Competition In The Railroad Industry

Dear Ms. Brown:

In accordance with the Director's Order issued on June 30, 2011, The Kansas City Southern Railway Company ("KCS") hereby supplements its written and oral testimony in this proceeding to briefly address questions posed during the June 22 hearing that deal with KCS's pricing power and length of haul. If there are any questions concerning this filing, please contact me by telephone at (202) 663-7823 or by e-mail at wmullins@bakerandmiller.com.

Sincerely,

William A. Mullins

Enclosures

cc: Warren K. Erdman
W. James Wochner
David C. Reeves

BEFORE THE
SURFACE TRANSPORTATION BOARD

STB EX PARTE NO. 705

COMPETITION IN THE RAILROAD INDUSTRY

SUPPLEMENTAL TESTIMONY OF THE KANSAS CITY SOUTHERN RAILWAY COMPANY

W. James Wochner, Esq.
David C. Reeves, Esq.
THE KANSAS CITY SOUTHERN RAILWAY COMPANY
P.O. Box 219335
Kansas City, MO 64121-9335
Telephone: (816) 983-1324
Facsimile: (816) 983-1227

William A. Mullins, Esq.
Robert A. Wimbish, Esq.
BAKER & MILLER PLLC
2401 Pennsylvania Ave., N.W.
Suite 300
Washington, DC 20037
Telephone: (202) 663-7823
Facsimile: (202) 663-7849

Attorneys for The Kansas City Southern Railway Company

Dated: July 25, 2011

BEFORE THE
SURFACE TRANSPORTATION BOARD

STB EX PARTE NO. 705

COMPETITION IN THE RAILROAD INDUSTRY

SUPPLEMENTAL TESTIMONY OF
THE KANSAS CITY SOUTHERN RAILWAY COMPANY

Pursuant to the Director's Order served in the above-captioned matter on June 30, 2011, The Kansas City Southern Railway Company ("KCS") hereby supplements its written and oral testimony to address questions raised at the June 22 hearing. Specifically, KCS will briefly address two questions asked of KCS's Executive Chairman, Mr. Michael Haverty, by Commissioner Mulvey regarding KCS's pricing power and system average length of haul.

Throughout this proceeding, KCS has consistently noted that as a result of the current market structure, there are significant differences between the larger carriers and KCS and that, because of those differences, KCS has significantly less pricing power than do the larger systems it connects with. As a result, KCS should not be treated the same as the larger Class I carriers if the Board were to adopt some form of "open access."

As noted by KCS, the vast majority of the traffic transported by the four largest Class I carriers is handled in single-line service while the vast majority of KCS's traffic – approximately 85% - KCS either receives from, or delivers to, other carriers. As a result of this market structure, KCS has less pricing power than its larger connections. Even at so-called "captive" locations, KCS simply does not have the market power to push its rate to such a level so as to capture the so-called "monopoly rent" that is theoretically available when a single carrier serves both the origin and the destination.

During the hearing, Commissioner Mulvey asked Mr. Haverty whether, if shortlines and other railroads like KCS were exercising pricing power to the same extent as the other Class I's, KCS and the shortlines should be treated differently than the larger Class I's with respect to any "open access" remedy. But, as noted, KCS is not exercising such pricing power. This is borne out by the fact that KCS has not had a rate complaint case brought against it for over 25 years, is consistently found to be revenue inadequate, and by the Board's most recent decision issued in Simplified Standards for Rail Rate Cases - 2009 RSAM and $R/VC_{>180}$ Calculations, Ex Parte No. 689 (Sub-No. 2) (STB served July 14, 2011)("2009 RSAM Decision").

The 2009 RSAM Decision can be used as a general indicator of pricing power by examining the gap between a carrier's "R/VC>180" – that is, what a railroad is *actually* charging its customers who have revenue-to-variable ("R/VC") cost ratios above 180% (i.e., "potentially captive traffic") - and the carrier's RSAM - what that railroad *needs* to charge on potentially captive traffic in order to become revenue adequate. The gap between the R/VC *actually* charged potentially captive traffic and the R/VC *needed* on that traffic to achieve revenue adequacy is a good proxy for a railroad's pricing power. In general, the narrower the gap between those two data points, the more pricing power a railroad has with respect to its potentially captive traffic, as shown by its ability to charge the rates it needs to charge to become revenue adequate. The fact that KCS has a significantly larger gap between its 4-year average R/VC>180 and its 4-year average RSAM requirement than any other Class I carrier, as shown in the 2009 RSAM Decision, is a strong indication that KCS generally does not have the same pricing power as the larger carriers do with respect to potentially captive traffic.

Commissioner Mulvey, in his dialogue with Mr. Haverty, also asked what the average length of haul was for the Kansas City Southern network including Kansas City Southern de

Mexico ("KCSM"). During the most recent quarter analyzed, the average length of haul for the Kansas City Southern network, including KCSM, was 441 miles.

As Commissioner Mulvey noted in his question to Mr. Haverty, in 2009 the average length of haul for all Class I railroads was approximately 918.5 miles.[1] As length of haul is somewhat indicative of overall pricing and revenue levels, with longer hauls reducing average costs and thereby increasing profit margins,[2] it is not surprising that KCS, which interchanges 85% of its moves with other, mostly larger, carriers has less pricing power than those larger connections.

In conclusion, the record in this proceeding does not support the notion that the rail industry is so anti-competitive or unresponsive as to warrant radical regulatory remedies, such as the requirement to quote a bottleneck rate or some form of mandatory reciprocal switching. The Board's processes and procedures, which have been updated, modernized, and significantly reformed over the past 7 years to accommodate the shippers' concerns, are more than adequate to protect shippers from unreasonable rates or unresponsive service.

However, if the Board does intend to propose or suggest modifications to its current access policies, it is clear that due to market structure, KCS does not possess the same pricing and operating characteristics of the largest Class I carriers and is more akin to a shortline or regional railroad. As such, any proposed changes to the existing regulatory structure should afford KCS similar treatment to that of shortline and regional railroad systems, lest the Board's changes actually

---

[1] Railroad Facts, 2010 Edition (Association Of American Railroads)(2009 revenues).

[2] For example, Union Pacific's President Jim Young testified at the June 22 hearing, "Where we make the money is in moving that car over the road."

facilitate elimination of the competition that KCS provides by allowing KCS's traffic to be cherry-picked by its larger connections.

Respectfully submitted,

William A. Mullins, Esq.
Robert A. Wimbish, Esq.
BAKER & MILLER PLLC
2401 Pennsylvania Ave., N.W.
Suite 300
Washington, DC 20037
Telephone: (202) 663-7823
Facsimile: (202) 663-7849

Attorneys For The Kansas City Southern Railway Company

W. James Wochner, Esq.
David C. Reeves, Esq.
THE KANSAS CITY SOUTHERN RAILWAY COMPANY
P.O. Box 219335
Kansas City, MO 64121-9335
Telephone: (816) 983-1324
Facsimile: (816) 983-1227

Dated: July 25, 2011